BellSouth **February 14, 1997**

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

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REPLY COMMENTS

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REPLY COMMENTS

BellSouth Corporation and BellSouth Telecommunications ("BellSouth") hereby submit their reply comments in the above-referenced matters.

I. INTRODUCTION AND SUMMARY

Access charge reform is the final of the three interrelated proceedings, the other two being interconnection and universal service, whose collective purpose is to enhance the competitive environment in the local exchange market in keeping with the deregulatory, market-oriented objectives of the Telecommunications Act of 1996. Access charge reform is fundamental to creating a regulatory environment that fosters competition on the merits. Market-based competition, however, cannot and will not occur if the Commission approaches access reform with the view that regulation can work better or faster or more effectively than the marketplace itself. The decision point for the Commission is one of direction--does it reverse five years of progress and return to a heavy-handed, interventionist regulatory regime or does it continue to seek out innovative and enlightened approaches that permit the market to play an ever-increasing role?

In 1991, the Commission took a bold step by fundamentally altering the way in which the largest LECs were regulated by replacing the traditional rate-of-return or cost plus system of regulation with the incentive-based framework of price caps. The objective of price-cap regulation was to harness the profit-making incentives common to all businesses in order to produce a set of outcomes that ultimately advance the public interest goals of just and reasonable rates as well as the development of a telecommunications infrastructure that can be used to offer innovative, high quality services.

The advantages of using an incentive-based regulatory approach to achieve the public policy goals has been acknowledged by the Commission.[1] Under incentive regulation, the LECs' primary means of increasing earnings is to become more efficient and to innovate in the provision of services. The economic experience and performance of the price cap LECs in general, and of BellSouth in particular, under incentive regulation supports the Commission's policy judgment regarding the superiority of incentive regulation. Access prices were reduced and new services were introduced. At the same time, BellSouth made significant investment in its network, deploying new technologies.

Despite the success of incentive regulation, there continue to be opportunities to improve the Commission's rules and, thus, stimulate far greater benefits. The key candidate for

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[1] In adopting price caps for LECs, the Commission observed that the basic rate-of-return mechanisms that form the foundation of its rate-of-return regulatory system were originally designed for the regulation of public utilities decades ago. The Commission moved to a price cap mechanism because it was concerned that "the system of regulation we currently employ does not serve to sharpen the competitiveness of this important segment of the industry at a time when telecommunications goods and services are becoming increasingly competitive, both nationally and internationally." *In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6790 (1990).

improvement is the current access charge system. These rules were never adjusted to complement price caps and incentive regulation. Indeed, there are several aspects of these rules that undercut the incentives that price cap regulation is supposed to provide. By far, the most pronounced tension between the Commission's price cap and access charge regimes lies in the switched access rate structure rules. There are other inefficiencies as well. All of these should be remedied by this proceeding.

The Commission has held out a prescriptive approach as one alternative to reforming access charges, and, not surprisingly, some parties seize upon it as the only way to reduce access prices. The formula advanced by these parties is simple: access rates must be set at cost and the proper measure of cost is total element long run incremental costs ("TELRIC"). Access rates should be reduced to TELRIC levels, and, so the story goes, the blessings of competition will flow. This refrain is hauntingly familiar. Twenty years ago, the Commission was engaged in an inquiry concerning appropriate pricing principles that would form the proper basis for market entry and exit. As the Commission stated:

> Our findings and conclusions herein are intended to provide the rules necessary to properly relate costs and both relative rates and rate levels. They should dissuade both incipient and established suppliers from participating in a particular service area because of the presumption that "protective umbrellas" will offset any patent inherent economic shortcomings.[2]

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[2] *In the Matter of American Telephone & Telegraph Company, Long Lines Department, Revisions of Tariff FCC No. 260 Private Line Services, Series 5000 (TELPAK)*, 61 FCC 2d 587, 615 (1976).

The Commission's conclusion, of course, was that rates should be set at fully distributed costs. Twenty years later, the Commission again is being urged to "properly relate costs and both relative rates and rate levels."[3] This time, however, it is TELRIC that is to provide the solution. In other words, the advocates of a presciptive approach would have the Commission ignore the successes of incentive regulation and, for the exclusive purpose of causing rate reductions, re-impose a failed form of cost-of-service regulation.

Regulation and the public policy that it reflects is not a game of "The Price Is Right."[4] The Commission's policy has been to promote infrastructure development and innovation. The Telecommunications Act likewise emphasizes the importance of these objectives. The Telecommunications Act requires the Commission to encourage the universal deployment of advanced telecommunications capabilities utilizing "price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment."[5]

A prescriptive approach, with its focus on rate-selection, not only would constitute bad public policy but also would be contrary to the express objectives and requirements of the Telecommunications Act.[6] Access charge reform affords the Commission an immediate

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3 *Id.*

4 *Trans Alaska Pipeline Cases*, 436 U.S. 631, 653 (1978).

5 Telecommunications Act of 1996, § 706(a). The Act defines advanced telecommunications capability "without regard to any transmission media or technology, as high-speed, switched, broadband telecommunications capability that enables users to originate and receive high-quality voice, data, graphics, and video telecommunications using any technology." Telecommunications Act of 1996 § 706(c)(1).

6 Even LEC competitors acknowledge the flaws in a prescriptive approach. "ALTS will strenuously object to the 'voodoo' regulation reflected in the prescriptive approach, where reductions in ILEC access prices are supposed to <u>foster</u> access competition." ALTS at 22.

opportunity to modify its regulatory approach and adopt additional incentives for the LECs to invest in local networks. On the other hand, a prescriptive approach, which eviscerates existing incentives and calls into question the earnestness of any future Commission promise of enlightened, efficient regulation, is a blueprint for disinvestment and stagnation. If the outcome of this proceeding is to set rates at incremental costs (regardless of the version), the Commission will seriously attenuate the incentives for incumbents to develop new and innovative services and for competitors to enter the local market on a facilities basis.[7]

Advocates of the prescriptive approach and TELRIC rates present this solution, ironically, as the "competitive" outcome. The fact of the matter is that in competitive markets, firms price above incremental costs and such prices may be above, below or equal to embedded costs or historical costs. The degree to which prices exceed incremental costs reflects market conditions. The fundamental competitive principle, ignored by the proponents of TELRIC, is that firms, on

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7 As Professor Kahn has explained:

> The historical institution of tightly regulated, franchised monopolies lacked competitive stimuli to innovation. But in offering those monopolists reasonable assurances that they would be permitted to recover their <u>total</u> prudently incurred investment costs--of unsuccessful as well as successful ventures--it did have a positive effect on their willingness and ability to innovate. As we have moved from cost-plus regulation to a competitive system, however, any requirement that charges to competitors for innovative new network elements be closely tied to some narrow measure of cost would destroy that previous symmetry. Rival entrants would then have the option of purchasing the results of successful innovation at bare cost, while leaving stranded the costs of unsuccessful ventures. The system would be one in which investors would be forced to absorb the costs of failed ventures--as in competitive markets generally--but be denied the offsetting opportunity, essential to innovation in a competitive system, to reap whatever rewards the unregulated market will provide for the ventures that turn out successfully.

Letter from Alfred E. Kahn to Reed E. Hundt, Chairman, Federal Communications Commission, January 14, 1997 (filed as an *ex parte* in CC Docket No. 96-98) ("Kahn Letter").

average, must recover their historical costs and earn a normal accounting profit. No firm would enter a market or engage in any activity if it expected that it would not recover all of its investment. While the market may dictate winners and losers, it is wholly inappropriate, as a matter of public policy, to pursue a regulatory approach that precludes the recovery of historical costs. This is particularly so in light of the fact that, absent regulation, the firm would have a reasonable opportunity for recovering such costs.

Further, proponents of the prescriptive approach simply disregard any consideration of the legal limitations to which the Commission is subject. The costs of a single, local network must be divided into their intrastate and interstate components.[8] The Commission's jurisdictional separations rules specify and mandate the process by which the division between jurisdictions takes place. Dual jurisdiction is not an economic concept but a legal one. Further, under the Communications Act, the Commission only has authority over interstate communications[9] and the full costs allocated to the interstate jurisdiction can only be recovered through interstate prices.[10]

An equally important consideration also overlooked by advocates of the prescriptive approach is that only incumbent LECs are subject to these regulatory aberrations. As such they are disadvantaged vis-á-vis their competitors. Hence, the challenge of access reform is to level

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[8] *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 145 (1930) (the division of a telephone company's costs between the interstate and intrastate jurisdictions is "essential to the appropriate recognition of the competent governmental authority in each field of regulation.")

[9] 47 U.S.C. § 152(b).

[10] The Commission is led to believe that if it sets interstate prices at TELRIC, that such prices are economically efficient. That is not true. Prices that are set for interstate services alone, without regard to intrastate prices, are not economically efficient. The Commission, however, has no authority over intrastate prices.

the playing field by mitigating the distortions caused by asymmetrical regulation. The prescriptive approach does the reverse--it increases the angle at which the competitive playing field is tilted.

The course the Commission should follow is, first, to modify the current access charge rules to reduce certain regulatory inefficiencies, such as those associated with the recovery of nontraffic sensitive costs, that are present. These inefficiencies stem from the implicit support that interstate services, such as exchange access, have historically provided to the intrastate jurisdiction. In the universal service proceeding, currently pending before the Commission, the Commission is required to establish an explicit universal service fund mechanism to replace the existing implicit support. Hence, a properly sized federal universal service fund could virtually eliminate the regulatory inefficiencies from access charges.[11] Nevertheless, if the universal service fund is insufficient to address the implicit support reflected in access charges, then there are important changes to the access charge rules that the Commission can make that will substantially improve the rules, benefit access customers and lay a foundation for the continued progress of local exchange competition.

While establishing a proper foundation or baseline is vital, such changes alone are not enough. The telecommunications landscape is in constant change. Regulation and the administrative process often lag behind the circumstances that create the need for the Commission to amend its regulations. The instant proceeding has been a long time in coming to fruition, and the marketplace has radically changed since the LECs first called for access reform. The

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[11] Because LECs will also contribute to the federal universal service fund, such contributions must be recovered. If the Commission does not establish a surcharge recovery mechanism that is assessed to end users, then LECs would have to recover their contributions through an access charge mechanism such as a per line charge assessed to interexchange carriers.

Commission already knows that market conditions are going to change and will continue to change. Indeed, marketplace adjustments will be the watchwords of the future. Further, the economic impacts of these adjustments will grow. Failure by the Commission to anticipate and plan for change would constitute poor public policy.

The public cannot afford a regulatory policy that merely reacts to change. Instead, the Commission must adopt a regulatory plan that keeps pace with shifting conditions. A market-based approach substitutes adaptive regulation for reactive regulation. It identifies changes in market conditions that should trigger changes in regulation. To suggest, as some commenters do,[12] that the Commission should postpone consideration of a market-based regulatory plan is simply gamesmanship.[13]

A well-conceived regulatory plan that lays out specific actions that will be implemented in the event that certain contingencies actually occur establishes continuity in policy making, increases the credibility of the policy program and promotes efficient investment by removing uncertainty about the Commission's future plans. In short, regulation becomes more predictable and efficient with less interference with the operation of the marketplace.

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12 *See, e.g.*, AT&T at 75-78; MCI at 63-66; and Sprint at 46-48.

13 In essence, suggesting the Commission consider adaptive regulation at a future date amounts to little more than asking for the Commission to foment regulatory uncertainty and inefficiency. It cannot be demonstrated that the public interest is served by following such a course. Such inaction only benefits competitors of LECs that seek to exploit the regulatory asymmetry that currently exists by extending on such asymmetrical regulation for an indeterminate period.

The Commission is committed to implementing policies that are consistent with the pro-competitive and deregulatory goals of the Telecommunications Act. These goals are only advanced by a market-based regulatory approach.

II. IMPROVEMENTS SHOULD BE MADE IN THE RATE STRUCTURE COMPONENTS OF THE ACCESS CHARGE RULES

Independent of the regulatory approach ultimately followed by the Commission, there are improvements that can and should be incorporated into the access charge rules. In particular, the Commission should modify the switched access charge rules. Currently, the majority of switched access charges are required by the Commission's rules to be assessed on a usage-sensitive basis. There is a general consensus across a broad range of commenters that such heavy reliance on usage-based charges is inefficient and should be corrected. Even after removing the regulatory inefficiencies, there are other adjustments that should be made in order to create a foundation upon which competition can grow.

A. Nontraffic Sensitive Costs Should Not Be Recovered On A Usage-Sensitive Basis

In the *Notice*, the Commission recognized that the current access charge rules contain many inefficiencies.[14] The vast majority of commenters concur with the Commission's conclusion that one of the most significant inefficiencies is usage-based recovery of nontraffic sensitive costs. Thus, there is virtually no dispute that the usage-based carrier common line charges should be changed.[15] BellSouth also has identified nontraffic sensitive components of local switching,

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14 *Notice* at ¶ 55.

15 *See, e.g.*, Ad Hoc at 7-8; MCI at 76-77; Time-Warner at 3-4; AT&T at 51-52; Sprint at 10-18.

currently recovered on a usage-sensitive basis, that should also be modified.[16] There are a number of access customers who likewise believe that usage-sensitive charges are an inappropriate means for recovering the nontraffic sensitive components of local switching.[17]

The nontraffic sensitive loop and local switching components are all associated with an end user's connection to the local network. Certainly, to the extent that cost recovery is effectuated through increased charges to end users, then the size of the access charge mechanism is reduced.[18] Likewise, the magnitude of the access charge problem is inversely related to the size of the federal universal service fund. An adequately sized federal universal service fund could replace all of the implicit support that is currently provided through interstate access charges that recover nontraffic sensitive costs and, thus, effectively reduce carrier common line charges to zero and fully recover the nontraffic sensitive component of local switching.

Nevertheless, in the event that non-access charge mechanisms prove insufficient, the Commission must adjust the access charge recovery mechanism for nontraffic sensitive costs. BellSouth, as well as most of the LECs, has suggested that the Commission adopt a non-usage sensitive recovery mechanism.[19] Specifically, BellSouth continues to recommend that the Commission permit LECs to recover their nontraffic sensitive elements through a per line charge that is assessed to interexchange carriers on the basis of presubscribed end-user lines.

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16 The nontraffic sensitive component of the local switch is the port to which the local loop is connected.

17 *See, e.g.*, TCG at 7-8; C&W at 9; Comptel at 30; LCI at 21.

18 Some commenters would have all nontraffic sensitive costs recovered directly from end users. *See, e.g.*, WorldCom at 30-32; Sprint at 10-13; TCI at 9-10. Removal of the cap on subscriber line charges so as to recover all nontraffic sensitive amounts directly from end users would resolve the regulatory inefficiency that is found in the existing usage sensitive structure.

19 BellSouth at 68. *See also* USTA at 55-57 ; SBC at 8; Ameritech at 9.

Other parties also favor changing the recovery mechanism for nontraffic sensitive costs. Interexchange carriers ("IXCs") and their representative associations acknowledge the superiority of a flat rate mechanism, such as a per line charge, over the current usage-based carrier common line charge.[20] As long as nontraffic sensitive costs will be recovered through charges assessed on interexchange carriers, then a flat rate charge is considered the most cost-causative recovery mechanism.[21]

The only concern expressed about a per line charge is that it could encourage the development of "dial around" services.[22] The idea that a flat rate charge assessed on presubscribed lines would be sufficient to alter the interexchange market is speculative at best Indeed, not all interexchange carriers subscribe to the view that "dial around" would be a significant problem.[23] Further, as WorldCom notes, as long as an IXC can recover the per line charge from its customers on a flat rate basis, then the presubscribed IXC would still be able to recover the per line charge even if the end-user customer uses dial around services.[24] Because interexchange carriers have been declared nondominant by the Commission, there is no regulatory obstacle to IXCs establishing rate structures that also include a flat rate charge.[25]

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20 *See, e.g.*, MCI at 76-77; LCI at 20-24; C&W at 10; Comptel at 29. User groups and state regulatory agencies also support the use of a per line charge for the recovery of nontraffic sensitive costs. *See, e.g.* Ad Hoc at 12-13; State Consumer Advocates at 28; California PUC at 4; NARUC at 12-14.

21 *See* MCI at 77.

22 *See, e.g.*, ACTA at 5-6.

23 *See* LCI at 23-24.

24 WorldCom at 38.

25 NARUC notes that nothing would preclude interexchange carriers from recovering their per line charges through the establishment of a charge that is assessed to their interexchange customers. NARUC at 12-14.

The mere possibility of "dial around" is an insufficient reason for the Commission not to change nontraffic sensitive recovery to a per line basis. The comments overwhelmingly establish that the practice of recovering nontraffic sensitive elements through usage-based charges must come to an end. The benefits to a flat rate recovery mechanism are settled. There is no meritorious countervailing consideration.

B. BellSouth's Recommendation For Recovering The Transport Interconnection Charge Should Be Adopted

A second adjustment recommended by BellSouth that would improve the efficiency of the access charge rules concerns the transport interconnection charge (TIC). In its comments, BellSouth identified cost components that are included in the TIC and that should be reassigned to other access elements.[26] Even after this reassignment is made, there is still a residual amount to be recovered. As shown in Attachment 5 to BellSouth's comments, the vast majority of the residual is attributable to the way in which jurisdictional separations over-allocated costs to the interstate jurisdiction, which in turn were then allocated to switched transport by the access charge rules.

Hence, the residual represents an over allocation of costs to the interstate jurisdiction. In essence, the interstate jurisdiction is providing implicit support to the intrastate jurisdiction by reducing the costs of interoffice transport that must be recovered through local service charges. It is for this reason that, in the universal service proceeding, BellSouth advocated recovering the TIC through the federal universal service fund. If the universal service fund, however, does not

[26] BellSouth, Attachment 5.

provide for the recovery of the TIC, then the Commission should modify the access charge rules so that the residual TIC is recovered on a per line basis.

Because jurisdictional over allocations are not traffic sensitive, a usage-based recovery method is not optimal. BellSouth, therefore has proposed that the residual TIC be recovered on a flat rate basis through a per line charge assessed to interexchange carriers. The residual TIC is attributable to regulatory policies that cannot be modified in this proceeding. Nevertheless, an improvement can be made by converting the current usage-based recovery mechanism to a per line mechanism.

Several non-LEC parties acknowledge that to the extent the TIC contains cost components that are more correctly associated with other access elements, those costs should be reallocated.[27] As to amounts not reallocated, the commenters urge that the TIC be eliminated, either immediately or over a short period of time. These parties suffer from the misperception that unless the amount can be assigned to a specific access element, the amount is not cost that should be recovered.

BellSouth's comments, however, clearly show that the residual is a real cost--it is not, however, attributable to a single access element or service. Indeed, for the most part, the residual reflects implicit support that the interstate jurisdiction provides to the intrastate jurisdiction. Implicit support, unless recovered through the yet-to-be established federal universal service fund,

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[27] *See, e.g.*, Ad Hoc at 27-28; ACTA at 13-15; C&W at 18-22. The most extreme position is advocated by AT&T which contends that the TIC should simply be eliminated. AT&T at 57. AT&T bases its position on the premise that all access rates should be set at TELRIC. AT&T's solution to historical regulatory cost allocations is merely to define them away. The fact of the matter is that the Commission is constrained by existing jurisdictional separations procedures and nothing in this proceeding can alter that fact. TELRIC is both irrelevant and unresponsive to the fact that interstate costs associated with several access elements are included in the TIC.

is a cost that must be recovered through interstate charges.[28] The task for the Commission, in this proceeding, is to determine the appropriate recovery mechanism. Given the nature of the cost, the recovery mechanism should be independent of the charges for specific access services. Further, because these costs are not traffic sensitive, the recovery should be on a flat rate basis. A per line charge, therefore, is the best alternative available.

C. Depreciation Reserve Imbalances Should Be Identified and Recovered Through A Bulk-Billed Mechanism

A third regulatory inefficiency identified by BellSouth is its existing depreciation reserve imbalance.[29] Historically, the Commission prescribed long asset lives in order to keep rates low. These prescribed lives have been too long and do not appropriately reflect the decline in economic value of assets, particularly for those accounts on which technology changes have had their biggest impact. The effect over time of the failure to have depreciation rates match the rapid technological displacements and the loss in economic value has been to set depreciation accruals at inappropriately low levels. The result is that the depreciation reserve is far short of what is actually necessary. For BellSouth, the interstate depreciation reserve imbalance is $579.4 million.[30]

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[28] Some parties apparently believe that the Court of Appeals decision in *Comptel v. FCC* 87 F. 3rd 522 (D.C. Cir. 1996)) would preclude recovery of the residual TIC. These parties would appear to suffer from the misapprehension that unless a cost is directly attributable to a service, any related charge is not cost-based. BellSouth has demonstrated that the residual TIC is primarily implicit support. The Commission not only has the authority to establish a recovery mechanism, it has the legal obligation to permit recovery.

[29] BellSouth at 6.

[30] The depreciation imbalance is the difference between BellSouth's actual reserve requirements (theoretical reserve) and its booked depreciation reserve. The quantification of BellSouth's reserve imbalance was provided as Attachment 3 to BellSouth's comments.

BellSouth has proposed to recover the amount associated with the depreciation reserve deficiency over an eight year period through a distinct bulk-billed mechanism.[31] Access charges would be reduced by the amount that is bulk-billed each year. At the end of the eight year period, the explicit depreciation reserve deficiency charge would be discontinued.

Some parties suggest that the Commission can ignore the depreciation reserve imbalance because, having elected price cap regulation, the LECs assumed the risk of under-depreciated plant.[32] Along the same lines, some argue that the LECs had ample opportunity to seek adjustments to price regulation to account for shortened useful lives or technological displacement.[33] These arguments ignore the regulatory reality. Since at least 1987 (well before the implementation of LEC price caps), BellSouth has repeatedly urged the Commission to permit LECs to control their own depreciation rates. The Commission has repeatedly declined to engage in depreciation reform that would permit carriers to recover their investments in a timely fashion. Hence, the depreciation reserve imbalance cannot be attributed to the LECs' inaction or failure to seek appropriate regulatory changes.

Further, in proposing an explicit reserve deficiency charge, BellSouth is not suggesting that it recover the reserve imbalance in addition to the revenues that BellSouth would be permitted to receive under the price cap plan. To the contrary, BellSouth would make downward adjustments to its traffic sensitive access charges through a price cap exogenous change. By

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[31] BellSouth at 7.

[32] *See, e.g.*, Ad Hoc at 64.

[33] *See, e.g.*, AT&T at 32.

making the exogenous change, BellSouth proposes to go beyond the requirements of the price cap rules which treat depreciation as endogenous.[34]

Accordingly, not only is BellSouth's proposal consistent with price cap regulation, but, also, it goes beyond the requirements of such regulation. BellSouth's proposal represents a balanced approach to remedying a past regulatory inefficiency. The depreciation reserve imbalance is identifiable and should be recovered explicitly rather than implicitly through access charges. The bulk-bill mechanism provides for such recovery. The exogenous adjustment that BellSouth would voluntarily make to its price cap index assures that access prices would no longer be distorted by this regulatory anomaly.

There are significant benefits to access customers if nontraffic sensitive costs, the residual TIC and the depreciation reserve imbalance are segregated from other access charges and recovered through explicit, flat rate mechanisms. As BellSouth pointed out in its comments, for Tier I LECs, usage-based switched access charges are currently \$.027 per minute.[35] Implementation of these explicit mechanisms could reduce usage sensitive switched access charges to approximately \$.010 per minute.[36] Even a modest growth in traffic could result in substantial savings to interexchange carriers.[37]

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[34] To be consistent with these rules, it is not necessary to make an exogenous change as BellSouth proposes. It would be sufficient to include the revenues and demand associated with the bulk billed depreciation element in the calculation of the actual price indices.

[35] BellSouth at 8.

[36] *Id.*

[37] For example, from 1994-1995, minutes of use for price cap LECs grew by approximately 26.3 billion minutes. Assuming that minutes grow by the same absolute amount in the first year following the implementation of the explicit recovery mechanisms, access customers would save approximately \$200 million in usage sensitive switched access charges. BellSouth at 9. Hopefully, interexchange carriers would flow these reductions through to their customers. Such a (Footnote Continued...)

D. Other Rate Structure Modifications

The comments in this proceeding have presented a range of adjustments to the Commission's access charge rules. Before the Commission creates a new series of rules that establish a switched access rate structure, the Commission must confront a more fundamental issue--does a prescribed rate structure serve any legitimate purpose?

When the access charge rules were first promulgated, the Commission used the switched access rate structure to manage interexchange competition. By specifying access rate structures, the Commission was mitigating the impact that differences in interexchange carrier size could have on access services. The rationale was that the then dominant interexchange carrier, AT&T, was so much larger than its competitors, that only it had the potential to avail itself of access services that were defined in terms of capacity (or volume).

Even though the Commission has now found AT&T to be nondominant, vestiges of this old principle remain in the rate structure limitations that continue to apply to switched access. For example, the access charge rules continue to require dedicated switched transport to be offered in a capacity that is no greater than a single DS3, even though there are transport services available in capacities of multiple DS3s that have cost characteristics quite distinct from a single DS3. The rate structure rules continue to preclude LECs from recognizing these economies in their service offerings.

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pass through of the reductions is necessary to stimulate network usage. Without such stimulation, price cap LECs would have difficulty in achieving the productivity offset in the price cap plan, particularly if a substantial portion of switched access charges become flat-rated, as proposed in this proceeding.

Similarly, these rules specify the way in which mileage must be determined for dedicated switched interoffice transport. The result is that LECs cannot offer a switched transport service based on a ring topology without first receiving a waiver from the Commission.[38]

None of these limitations make economic sense. They are not cost related nor do they reflect sound engineering considerations. At best, they are regulatory determinations made to achieve regulatory purposes. The regulatory purposes for these limitations, however, no longer exist.[39] Continuing these limitations would be detrimental to innovation and competition.

Most importantly, these limitations delay the introduction of new service capabilities. Rate structure rules establish a rigid paradigm that is based on a snapshot view the network. In an environment characterized by rapid technological developments, it is impossible to anticipate the new capabilities that may become available over time. Moreover, any rules that delay the deployment of new technology are inconsistent with the Telecommunications Act. Section 706 directs the Commission to encourage the widespread deployment of advanced telecommunications capabilities by, among other things, removing barriers to infrastructure investment. Rules that inhibit a LEC's ability to introduce new services and otherwise use new technologies unquestionably constitute a barrier to infrastructure development.

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38 While the Commission recently granted a waiver of its rules to certain LECs to offer switched transport services based on a ring topology, the LECs were still constrained to provide such services at a capacity no higher than a single DS3.

39 As the Commission made clear in the *Notice*, it will only apply its access charge rules to incumbent LECs. Thus, the access charge rules cannot be used to moderate interexchange competition because interexchange carriers can avoid the impact of the rate structure limitations simply by obtaining service from an alternative provider.

A case in point is advanced intelligent network (AIN) capabilities. The Commission's rules do not accommodate this new technology. Over a year ago, BellSouth filed a waiver to provide AIN-based services.[40] The waiver languishes in regulatory limbo. The solution is not, as some would suggest, that the Commission invent new rules that define how an AIN service and other capabilities should be structured.[41] It is certain by the time that such rules became effective they would be outdated. Instead, the Commission should abandon rate structure rules. The Commission should heed the guidance of Section 706 of the Telecommunications Act and remove the regulations that obstruct technology deployment

The rate structure limitations are also inconsistent with the competitive market that the Commission seeks to foster. The limitations single out LECs as a class of competitor and preclude them alone from serving customer demand. All other competitors are not subject to the limitations and are free to provide services in a way that satisfy customer expectations. There is absolutely no rational, legal, economic or policy reason to prevent incumbent LECs from offering alternative rate structures or introducing new services to meet customer demand. Indeed, any limiting rule not only places incumbent LECs at a competitive disadvantage but also harms access customers.

While removing all switched access rate structure limitations is the appropriate next step, after thirteen years, the Commission may be hesitant about making such an abrupt change. If the Commission believes that the public interest is served by a core switched access rate structure that

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40 In its waiver, BellSouth not only proposed to offer retail services but also to make an AIN tool-kit available that would have enabled other providers to provide AIN-based services using BellSouth's network.

41 *See, e.g.*, AT&T at 62-63.

is uniformly available across the nation, then all that is necessary is that all LECs be required to provide only the core elements. Such a core rate structure should not, nor is it necessary to, preclude LECs from offering new services or assembling existing services into packages that respond to customer demand.[42]

III. THE COMMISSION SHOULD ADOPT A MARKET-BASED ACCESS REFORM APPROACH

Predictably, many commenters oppose a market-based approach to access reform. For the most part, these commenters are actual competitors or potential competitors of the LECs. Their interests are served by maintaining asymmetrical regulation for as long as possible. In short, these parties urge the Commission to follow a path that protects competitors at the expense of competition.

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[42] In Section VII of its comments, BellSouth discussed elements that could be considered as within the core rate structure. As BellSouth's comments indicate, even within the core structure, the Commission must afford LECs flexibility. If the Commission overly defines the core structure, such over definition could have adverse consequences. For example, in its comments, BellSouth indicated that its preference for providing SS7 services is to rearrange its signaling network so as to reduce the number of signaling links and STPs utilized, and that would render the actual STP locations transparent to the customer. Under this arrangement, an access customer could gain access to BellSouth's signaling network for exchange and exchange access services for all of BellSouth's thirty-eight LATAs using connections to a single STP. The disaggregated rate structure used by Ameritech, and being considered by the Commission in this proceeding, is incompatible with the network architecture that BellSouth intends to deploy. Thus, it is crucial that the core rate structure not be dependent on a particular network architecture. Indeed, the fact that some rate structures are dependent on (and only justified by) certain network architectures is further reason to abandon mandatory rate structures. However, the other extreme position, which would remove any cost recovery from access charges for SS7, is completely without merit, and must be rejected by the Commission. WorldCom at 57.

Much of the opposition is built around the myth that there is no competition in the local and exchange access market. The impression that these parties attempt to convey is that competitive entry has yet to commence.[43]

Commenters would have the Commission only consider competitive activity following the enactment of the Telecommunications Act. These commenters ignore that competitive networks of alternative access providers have been around for some time. Indeed, as BellSouth showed in its comments, competitive networks have expanded significantly over the last few years.[44] By the end of 1996, there were a total of at least 94 alternative networks in operation in 50 different cities in BellSouth's nine states. Further, contrary to conventional wisdom, expansion is not concentrated in just Tier I cities. For BellSouth, the most significant growth took place in Tier II and Tier III markets with the expansion of regional competitive access providers such as Brooks Fiber Properties, American Communications Services Inc. and IntelCom Group.

Another myth about these competitive networks is that they are limited to transport services. The facts, however, reveal a very different picture. These competitive networks have capabilities beyond the mere transport of telecommunications services. At present, 40 of the alternative networks that operate in BellSouth's territory are equipped with switching capabilities. Another 34 networks are scheduled to provide switched services in 1997.

Thus, even without the interconnection provisions of the Telecommunications Act, there exists a solid competitive foundation. The Telecommunications Act will not create competition

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[43] *See, e.g.*, AT&T at iii; C&W at 25-26.

[44] *See* "BellSouth CAP Status Report", Attachment 1 to BellSouth's Comments ("BellSouth CAP Status Report").

from scratch, but rather will enhance and facilitate expansion of these networks as well as provide additional opportunities for new entrants. As opposed to being the starting point of competition, as some commenters suggest, the Telecommunications Act eases competitive entry and expansion.

Likewise, the suggestion that the local exchange constitutes a bottleneck rings hollow in view of the alternative networks that are in place.[45] It is clear that LEC networks can be duplicated. Certainly, the opportunity to obtain unbundled elements will bear on a competitor's choice of whether to build its own facilities or use the incumbent LEC's facilities. The fact that the competitors may choose unbundled elements does not convert the LEC network into a bottleneck--indeed, the fact that choice exists belies the assertion.[46]

To be sure, competition will continue to expand. In anticipation of this expansion and in recognition of the competition that exists, it is important to have rules in place that can accommodate the changes to marketplace conditions as they arise. AT&T's suggestion that the Commission should let competition develop first and then, in yet another proceeding, determine if any rule changes should occur is utter nonsense.[47] Competition is already here. The Commission's response should be a resounding "no." AT&T wants the Commission to maintain a regulatory policy firmly grounded in reactive regulation.

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[45] WorldCom at 13-20; API at 4-5; ALTS at 14-17; TRA at 7-10; MCI at 55; AT&T at i.

[46] Even if the LEC network had elements that could be considered "essential", the availability of unbundled elements to all requesting telecommunications carriers eliminates any competitive concern.

[47] *See* AT&T at 85-87.

A regulatory approach that is based on playing "catch-up" may be good for LEC competitors but it is not good for competition. Competition displaces the need for regulation. Indeed, regulation and competition are incompatible. Unnecessary regulatory intervention only serves to distort the marketplace and to create ineffective and inefficient competitors.

Some commenters view a market-based approach to access reform as premature.[48] They are wrong. A market-based approach reflects a self-adapting regulatory policy that enables market forces to replace regulation as market conditions warrant. By design, adaptive regulation, and, hence, a market-based approach, does not get ahead of the market. Instead, it removes the lag that characterizes traditional regulatory policies. The adaptive regulatory policies are implemented when the competitive conditions warrant adjustments in regulation.

Equally flawed is the perception that a market-based approach would create uncertainty.[49] A market-based approach becomes a policy road map that lays out in advance the specific actions that the Commission will take in response to the occurrence of specifically identified contingencies. Such a well-enunciated plan provides a firm foundation for market participants to make investment decisions. It is the absence of such a clear vision that gives rise to uncertainty and creates the opportunity for endless regulatory disputes.[50]

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48 *Id. See also* Florida PSC at 3-4.

49 *See, e.g.*, C&W at 25-26.

50 One of the most significant disadvantages to the traditional, reactive regulatory paradigm is that it shifts the focus of rivalry from the competitive marketplace to the regulatory arena. Regulation can confer a competitive advantage on a class of competitors. In the local market, where only the incumbent is regulated and all other participants are effectively deregulated, the Commission's asymmetric regulatory policies provide an unparalleled advantage to LEC competitors. Maintaining that regulatory advantage becomes a key business strategy. The distaste for a market-based approach, in part, reflects the awareness that it establishes the conditions under which the regulatory advantage will evanesce.